

M. PUBLICLY SUPPORTED ORGANIZATIONS

The term "publicly supported organizations" generally refers to organizations described in IRC 170(b)(1)(A)(vi) and 509(a)(2). The purpose of this paper is to discuss the support requirements for both these kinds of organizations. It does not discuss, except in passing, those rules that determine whether an organization "normally" receives public support, since the intent is to provide a basic picture of the support requirements.

Organizations that seek classification as publicly supported organizations are required to meet tests to determine whether they "normally" receive a substantial amount of public support. Thus, the first step is to determine the total support of the organization with respect to the period for which qualifications is in question.

For IRC 170(b)(1)(A)(vi) organizations total support is determined by reference to IRC 509(d) and Reg. 1.170A-9(e)(7) and it includes:

- (a) gifts, grants, contributions, or certain membership fees;
- (b) net income from unrelated business activities, whether or not such activities are carried on regularly as a trade or business;
- (c) gross investment income (unless includable under IRC 511);
- (d) tax revenues levied for the benefit of an organization and either paid to or expended on behalf of the organization; and
- (e) the value of services or facilities (exclusive of services or facilities generally furnished to the public without charge) furnished by a governmental unit to the organization without charge.

The total support of an IRC 170(b)(1)(A)(vi) organization does not include:

- (a) amounts received from the exercise or performance by the organization of its charitable, educational, or other

IRC 501(c)(3) purpose constituting the basis for its exemption. For example, amounts received for admissions to the theater are excludable from total support;

(b) contributions of services for which a deduction is not allowable;

(c) the value of exemption from any federal, state or local tax or any similar benefit;

(d) capital gains; and

(e) loan repayments.

There is a special rule for certain kinds of payments from a governmental unit if amounts are received from the exercise or performance of an exempt function, such as where by contract an organization designs and develops a product for the armed forces. Payments under this kind of arrangement would be excludable from total support. On the other hand, amounts received from a governmental unit to enable an organization to provide a service to or to maintain a facility for the direct benefit of the public, as, for example, payments made to nursing homes to provide health care or similar services to the residents, are included in total support. Reg. 1.170A-9(e)(8)(ii). The Service is currently considering how to characterize medicare payments in light of the decision in Turecamo v. Commissioner, 554 F. 2d 564 (1977). The issue we are considering is whether these payments are includable in the total support of an IRC 170(b)(1)(A)(vi) organization under the rule just described or whether they are excludable as payments received from individuals for the performance of the organization's exempt function.

In addition to the exclusions listed above, Reg. 1.170A-9(e)(6)(ii) provides that "unusual grants" will be excluded from total support. An unusual grant is one that is unusually large, unexpected, and one that would adversely affect the IRC 509 status of the organization. Whether or not a grant is an unusual grant is generally determined by the factors listed in the regulations.

Once the total support of the organization is determined the next step is determining whether an organization has enough public support (a portion of total support) to satisfy either the "33 1/3 percent support test" or the "10 percent facts

and circumstances test". Both tests generally measure an organization's public support over a four year period, or in the case of new organizations a shorter period (except in the case of new organizations that have an extended advance ruling). The measuring periods are intended to test whether an organization "normally" receives public support.

Public support for purposes of IRC 170(b)(1)(A)(vi) consists of two elements - contributions from the general public and support from governmental units. Under Reg. 1.170A-9(e)(6)(i) contributions by an individual, a trust or a corporation over the period being measured are ordinarily considered to be public support to the extent they do not exceed 2 percent of the organization's total support for the period. Contributions in this context include grants from foundations and membership dues for which there is no consideration. Not subject to the 2 percent limit are contributions from other publicly supported organizations (unless the other publicly-supported organization is distributing a contribution to it that has been earmarked for the ultimate recipient). The rationale in this situation is that all of the contribution is an indirect contribution from the general public. Rev. Rul. 77-255, 1977-2, C.B. 75, holds that contributions from a business league are subject to the 2 percent limit since, although the business league might be publicly supported, it is not organized and operated for IRC 170(c)(2) purposes.

Support from a governmental unit is also excepted from the 2 percent limit since there is no statutory requirement to determine whether it is support from the general public. The most significant question relating to government support is whether it is in the nature of a grant or compensation for the performance of an exempt function (discussed above). Rev. Rul. 75-435, 1975-2 C.B. 215, provides that support from foreign governments may be considered for purposes of the support test.

Once an organization's total support and public support are computed, the question of whether the organization meets the "33 1/3 percent of support test" is a mathematical problem. The regulations state this in terms of a fraction with public support as the numerator and total support as the denominator. As is suggested by the name of the test, this fraction must equal at least 1/3 for the entire measuring period if the organization is to meet the support test.

The "33 1/3 percent of support test" is a safe harbor in testing whether an organization is publicly supported. If an organization receives less than 1/3 of its support from the general public and from governmental units, it still may be

publicly supported if it meets the "10 percent facts and circumstances test". Reg. 1.170A-9(e)(3)(i).

The mathematics of the 10 percent facts and circumstances test is similar to mathematics involved in the "33 1/3 percent of support test". However, in addition to satisfying the mathematical requirement that 1/10 (as opposed to 1/3) of its support comes from the general public and governmental units, an organization must demonstrate that it meets enough of the additional "facts and circumstances" listed in Reg. 1.170A-9(e)(3) to indicate that it is publicly supported. Generally these facts and circumstances are designed to show that an organization will attract the kind of public support referred to in IRC 170(b)(1)(A)(vi).

The kinds of organizations that usually qualify under the IRC 170(b)(1)(A)(vi) support test are museums, libraries, community centers and community funds such as the United Givers organizations.

When the Tax Reform Act of 1969 was enacted, an additional category of publicly supported organizations was added to the Code. (IRC 170(b)(1)(A)(vi) had previously been enacted, effective all years beginning after December 31, 1963.) The new category of publicly supported organizations, described in IRC 509(a)(2), was intended to include organizations that receive a major part of their support from the performance of an exempt function. Thus, in computing an IRC 509(a)(2) organization's total support the same formula (other than the exclusions) used in computing an IRC 170(b)(1)(A)(vi) organization's total support is used, except however gross receipts from admissions, sales of merchandise, performance of services, and furnishing facilities in any activity (that is not an unrelated trade or business) are included. The items excluded from total support, in the case of IRC 509(a)(2) organizations, do not include amounts received from the exercise or performance by the organization of its charitable, educational or other IRC 501(c)(3) purpose. Thus, payments from a governmental unit for performing its exempt function are included in total support. The unusual grant rules remain the same.

An IRC 509(a)(2) organization must satisfy two tests - a test of whether it receives more than 1/3 of its support from the public in the form of gifts, grants, contributions, membership fees and amounts received for the performance of an exempt function, and a test limiting the amount of support it receives from gross investment income and certain unrelated trade or business income to no more than 1/3 of its total support.

The steps taken in determining whether or not an organization meets the IRC 509(a)(2) test are therefore similar in many respects to the steps taken to determine whether the IRC 170(b)(1)(A)(vi) support requirement is met. First, the total support of the organization is determined using the formula discussed above. Second, the amount of public support (a portion of total support) is determined.

Public support in the form of gifts, grants, contributions, etc. must be from persons other than disqualified persons, from governmental units, or from organizations described in IRC 170(b)(1)(A) other than clauses (vii) and (viii). It should be noted that Reg. 53.4946-1(b)(2) does not except organizations described in IRC 509(a)(2) or (3) from the definition of a disqualified person for purposes of IRC 509(a)(2). The practical effect of this is to limit the amount of public support than an organization can receive from IRC 509(a)(2) or (3) organizations.

Exempt function income is includable to the extent that it does not exceed \$5,000 or 1 percent of the organization's support for the year. This means that a distinction must be made between grants and amounts received from the performance of an exempt function. Also, the judgment must be made as to whether a series of payments is received from one or more governmental bureaus or agencies.

Once support from the public is determined it becomes the numerator of a fraction, the denominator of which is total support, and this fraction is the measure of whether the organization receives more than 1/3 of its support from the general public.

The numerator of the fraction used to determine whether an organization receives no more than 1/3 of its support from gross investment income and certain unrelated trade or business income consists of gross investment income as defined in IRC 509(e) and the excess of the amount of unrelated trade or business taxable income of a trade or business acquired after June 30, 1975, over the amount of tax imposed by IRC 511 on that income. The denominator of the fraction is the organization's total support.

Generally, the components of gross investment income are those that are excluded from unrelated business income under IRC 512(b). Reg. 1.509A-3(m) also points up a distinction that should be made in characterizing certain items of passive income such as rent. Certain rents or interest on loans should be characterized as amounts received for the performance of an exempt function. This

rule applies in situations involving activities like the rental of housing to individuals in a charitable class.

Two more rules are worth mentioning in passing. The first contained in Reg. 1.509A-5(a)(1) provides attribution rules where an organization distorts its support picture by spinning off a related IRC 509(a)(3) organization. The second rule distinguishes between IRC 509(a)(2) and IRC 170(b)(1)(A)(vi) organizations. It provides that an organization that receives almost all of its support from exempt function income will not satisfy the requirements of IRC 170(b)(1)(A)(vi) and thus, by implication, suggests that the organization, if it qualifies at all, must qualify under IRC 509(a)(2).

A theater or an organization that is otherwise dependent on exempt function income is the kind of organization that usually qualifies under IRC 509(a)(2).